Chapter 4
Credit Underwriting

Overview

In this Chapter

This chapter contains the following topics.

4.01 How to Underwrite a VA-Guaranteed Loan

VA Underwriting Standards

VA loans involve a veteran's benefit. Therefore, lenders are encouraged to make VA loans to all qualified veterans who apply.

VA's underwriting standards are intended to provide guidelines for lenders' underwriters as well as VA's underwriters. Underwriting decisions must be based on sound application of the underwriting standards, and underwriters are expected to use good judgment and flexibility in applying the guidelines set forth in the following pages.

Basic Requirements

By law, VA may only guarantee a loan when it is possible to determine that the veteran

- is a satisfactory credit risk, and
- has present and anticipated income that bear a proper relation to the contemplated terms of repayment.

VA's underwriting standards are incorporated into VA regulations at 38 CFR 36.4337 and explained in this chapter. This chapter addresses the verifications, procedures, and analysis involved in underwriting a VA-guaranteed loan. It provides guidance on how to treat income, debts and obligations, credit history, and so on., and how to present and analyze these items on VA's loan analysis form. It does not deal with every possible circumstance that will arise; therefore, underwriters must apply reasonable judgment and flexibility in administering this important veteran's benefit.

[38 CFR 36.4337]

Lender Responsibility

Lenders are responsible for

- developing all credit information
- properly obtaining all required verifications and the credit report
- ensuring the accuracy of all information on which the loan decision is based
- complying with the law and regulations governing VA's underwriting standards, and with VA's underwriting policies, procedures, and guidelines, and
- certifying as to compliance with all of the above.

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4.01 How to Underwrite a VA-Guaranteed Loan, Continued

Lender Procedures

Section 5.02 provides an overview of all procedures which must be completed when making a VA loan. The procedures below address only the credit underwriting of the loan.

Step	Action
1	Initiate the VA and CAIVRS inquiries described in Section 4.06 in this chapter.
2	Obtain all necessary verifications. • The applicant's authorization can be obtained for each verification needed, or on one blanket authorization form (attach a copy of the blanket authorization to each verification requested, including VA Form 26-8937, Verification of VA Benefit-Related Indebtedness, if applicable). • The credit report and verifications can be ordered by the lender or its agent or a party designated by the lender to perform that function. However, these documents must always be delivered by the credit reporting agency or verifying party directly to the lender or its agent, and never to another party. That is, while a lender may delegate authority for a builder, realtor, or other person to order the report for the lender, the report may not be delivered to such builder, realtor, and so on, and may not pass through the hands of any such party or the applicant.
3	• Compare similar information received from different sources. For example: – The number of dependents provided on the URLA, tax returns, credit report, and so on, should be the same. – The status of debts provided on the URLA and credit report should be the same. • Resolve any discrepancies.
4	Complete VA Form 26-6393, Loan Analysis, in conjunction with a careful review of the loan application and supporting documentation. The form is not required for IRRRLs (except IRRRLs to refinance delinquent VA loans).

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4.01 How to Underwrite a VA-Guaranteed Loan, Continued

Lender Procedures (continued)

Step	Action
5	Indicate the loan decision in item 50 of the Loan Analysis after ensuring that the treatment of income, debts, and credit is in compliance with VA underwriting standards.
6	***Loans closed by an automatic lender*** The underwriter must certify review and approval of the loan by signing item 51 of the Loan Analysis (for Loan Prospector cases, see Section 4.08. For nonsupervised automatic lenders, this must be a VA-approved underwriter. ***Prior approval loans*** The individual with authority to determine that the loan meets VA credit standards and should be submitted to VA, must sign item 51 of the Loan Analysis.
7	An officer of the lender authorized to execute documents and act on behalf of the lender must complete the following certification: "The undersigned lender certifies that the loan application, all verifications of employment, deposit, and other income and credit verification documents have been processed in compliance with 38 CFR Part 36; that all credit reports obtained in connection with the processing of this borrower's loan application have been provided to VA; that, to the best of the undersigned lender's knowledge and belief, the loan meets the underwriting standards recited in Chapter 37 of title 38 United States Code and 38 CFR Part 36; and that all information provided in support of this loan is true, complete and accurate to the best of the undersigned lender's knowledge and belief." **[38 CFR Part 36]**

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4.01 How to Underwrite a VA-Guaranteed Loan, Continued

Underwriting Special Types of Loans

The underwriting standards and procedures explained in this chapter apply to these special types of loans generally. However, some special underwriting considerations also apply and can be found as follows:

Type of Loan	Handbook Chapter
Joint Loans	7.01
Energy Efficient Mortgages (EEMs)	7.03
Graduated Payment Mortgages (GPMs)	7.06
Growing Equity Mortgages (GEMs)	7.07
Loans Involving Temporary Interest Rate Buydowns	7.08
Farm Residence Loans	7.09

Refinancing Loans

While the underwriting standards detailed in this chapter apply to “cash-out” refinances, IRRRLs generally do not require any underwriting.

IRRRLs made to refinance VA loans 30 days or more past due must be submitted to VA for prior approval. It must be reasonable to conclude that

- the circumstances that caused the delinquency have been corrected, and
- the veteran can successfully maintain the new loan.

Reference: See Chapter 6 for details on all types of refinancing loans.

4.02 Income

Underwriter's Objectives

Identify and verify income available to meet

- the mortgage payment
- other shelter expenses
- debts and obligations, and
- family living expenses.

Evaluate whether verified income is

- stable and reliable
- anticipated to continue during the foreseeable future, and
- sufficient in amount.

Importance of Verification

Only verified income can be considered in total effective income.

Income of a Spouse

Verify and treat the income of a spouse who will be contractually obligated on the loan the same as the veteran's income.

To ensure compliance with the Equal Credit Opportunity Act (ECOA), do **not** ask questions about the income of an applicant's spouse unless the

- spouse will be contractually liable
- applicant is relying on the spouse's income to qualify
- applicant is relying on alimony, child support, or separate maintenance payments from the spouse or former spouse, or
- applicant resides in a community property state or the security is in such a state.

Note: In community property states, information concerning a spouse may be requested and considered in the same manner as for the applicant, even if the spouse will not be contractually obligated on the loan.

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4.02 Income, Continued

ECOA Considerations

Restrict inquiries related to the applicant's spouse to the situations listed in the "Income of a Spouse" heading in this section.

Always inform the applicant (and spouse, if applicable) that they do not have to divulge information on the receipt of child support, alimony, or separate maintenance. However, in order for this income to be considered in the loan analysis, it must be divulged and verified.

Income cannot be discounted because of sex, marital status, age, race, or other prohibited bases under the Equal Credit Opportunity Act (ECOA).

Treat income from all sources equally; that is, the fact that all or part of an applicant's income is derived from any public assistance program is not treated as a negative factor, provided the income is stable and reliable.

Income from Non-Military Employment

Verification: General Requirement
Verify a minimum of two years employment.

If the applicant has been employed by the present employer less than two years

- verify prior employment plus present employment covering a total of two years
- provide an explanation of why two years employment could not be verified.
- compare any different types of employment verifications obtained (such as, Verification of Employment, pay stubs, tax returns, and so on) for consistency, and
- clarify any substantial differences in the data that would have a bearing on the qualification of the applicant.

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4.02 Income, Continued

Income from Non-Military Employment (continued)

Verification: Standard Documentation
Acceptable verification consists of:

- VA Form 26-8497, Request for Verification of Employment (VOE) or any format which furnishes the same information as VA Form 26-8497, plus
- a pay stub if the employer normally provides one to the applicant.

If the employer does **not** indicate the probability of continued employment on the VOE, the lender is not required to request anything additional on that subject.

The VOE and pay stub must be no more than 120 days old (180 days for new construction).

- For loans closed automatically, the date of the VOE and pay stub must be within 120 days of the date the note is signed (180 days for new construction).
- For prior approval loans, the date of the VOE and pay stub must be within 120 days of the date the application is received by VA (180 days for new construction).

The VOE must be an original. The pay stub may be an original or a copy certified by the lender to be a true copy of the original.

Verification: Employment Verification Services

Lenders may use VOEs supplied by an employment verification service only if VA has approved the use of VOEs from that particular provider. VA has approved two:

- "FULL" verifications of employment through "The Work Number for Everyone," a service of the TALX Corporation. (No pay stub is needed with the TALX verification.)
- Verifications through VIE, Inc., a wholly owned subsidiary of Wells Fargo Home Mortgage. (VIE verifications must be supplemented by a pay stub or telephone verification of the applicant's current employment. For telephone verification, document the date of verification and the name, title, and telephone number of the person with whom employment was verified.)

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4.02 Income, Continued

Income from Non-Military Employment (continued)

Verification: Alternative Documentation
Alternative documentation may be submitted in place of a VOE if the lender concludes that the applicant's income **is** stable, reliable, and anticipated to continue during the foreseeable future; that is, if the applicant's income qualifies as effective income.

Two years employment is not required to reach this conclusion.

Alternative documentation consists of

- pay stubs covering at least the most recent 30-day period
- W-2 forms for the previous two years, and
- telephone verification of the applicant's current employment. Document the date of verification and the name, title, and telephone number of the person with whom employment was verified.

If the employer is **not** willing to give telephone verification of applicant's employment or the pay stubs or W-2 forms are in any way questionable as to authenticity, use standard documentation. Alternative documentation cannot be used.

Pay stubs and W-2 forms may be originals or copies certified by the lender to be true copies of the originals.

Verification: Additional Documentation for Persons Employed in the Building Trades or Other Seasonal or Climate-Dependent Work
In addition to the standard documentation (VOE and pay stub), obtain

- documentation evidencing the applicant's total earnings year to date
- signed and dated individual income tax returns for the previous two years, and
- if applicant works out of a union, evidence of the union's history with the applicant.

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4.02 Income, Continued

Income from Non-Military Employment (continued)

Analysis: General Guidance

Income analysis is not an exact science. It requires the lender to underwrite each loan on a case by case basis, using:

- judgment
- common sense, and
- flexibility, when warranted.

Analyze the probability of continued employment (that is, whether income is stable and reliable) by examining the

- applicant's past employment record
- applicant's training, education, and qualifications for his/her position
- type of employment, and
- employer's confirmation of continued employment, if provided.

Two years' employment in the applicant's current position is a positive indicator of continued employment. It is **not** a required minimum and **not** always sufficient by itself to reach a conclusion on the probability of continued employment.

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4.02 Income, Continued

Analysis: Applicant Employed Less Than 12 Months

Generally, employment less than 12 months is **not** considered stable and reliable. However, it may be considered stable and reliable if the individual facts warrant such a conclusion. Carefully consider

- the employer's evaluation of the probability of continued employment, if provided, and
- whether the applicant's training and/or education equipped him or her with particular skills that relate directly to the duties of his/her current position.

  For the most part, this applies to skilled positions. Examples include nurse, medical technician, lawyer, paralegal, and computer systems analyst.

- If the probability of continued employment is high-based on these factors then the lender may give favorable consideration to including the income in total effective income.

  An explanation of why income of less than 12 months duration was used must accompany the loan submission.

- If the probability of continued employment is good, but not as well supported or employment will be terminated at some point in the future which can be reasonably estimated, the lender may still consider the income of an applicant who has been employed at least 6 months to partially offset debts of 10 to 24 months duration.

- Determine the amount which can be used, based on such factors as
  - the employer's evaluation of the probability of continued employment, if provided
  - the length of employment (for example, 10 months versus six months).
- Include an explanation with the loan submission.

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4.02 Income, Continued

Analysis: Recent History of Frequent Changes of Employment

Short-term employment in a present position combined with frequent changes of employment in the recent past require special consideration to determine stability of income. Analyze the reasons for the changes in employment.

Reference: See Section CI.04 under Current Issues for a discussion of frequent job changes by individuals with low-to-moderate incomes.

Give favorable consideration to changes for the purpose of career advancement in the same or related field.

Favorable consideration may not be possible for changes

- with no apparent betterment to the applicant, and
- from one line of work to another.

If the lender includes applicant’s income in effective income, an explanation must accompany the loan submission.

Income from Overtime Work, Part-time Jobs, Second Jobs, and Bonuses

Generally, such income cannot be considered stable and reliable unless it has continued (and is verified) for two years.

To include income from these sources in effective income:

- The income must be regular and predictable, and
- there must be a reasonable likelihood that it will continue in the foreseeable future based on
  - its compatibility with the hours of duty and other work conditions of the applicant’s primary job, and
  - how long the applicant has been employed under such arrangement.

The lender may use this income, if it is not eligible for inclusion in effective income, but is verified for at least 12 months, to offset debts of 10 to 24 months duration. Include an explanation.

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4.02 Income, Continued

Income from Commissions

Verification
When all or a major portion of the applicant's income is derived from commissions, obtain the following documentation:

- Verification of employment or other written verification which provides
  - the actual amount of commissions paid year-to-date
  - the basis for payment (that is, salary plus commission, straight commission, or draws against commission)
  - when commissions are paid (that is, monthly, quarterly, semiannually, or annually), plus
- individual income tax returns, signed and dated, plus all applicable schedules for the previous two years (or additional periods if needed to demonstrate a satisfactory earnings record)

Analysis
Generally, income from commissions is considered stable when the applicant has obtained such income for at least two years.

- Less than two years cannot usually be considered stable unless the applicant has had previous related employment and/or extensive specialized training.
- Less than one year can rarely qualify. In-depth development is required for a conclusion of stable income on less than one year cases.

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4.02 Income, Continued

Self-Employment Income

Verification
Obtain the following documentation:

- Current financial statements prepared in a generally recognized format, including:
  - year-to-date profit and loss statement
  - current balance sheet
    Note: The financial statements must be sufficient for a loan underwriter to determine the necessary information for loan approval. The lender may require accountant-prepared financial statements or financial statements audited by a Certified Public Accountant if needed to make such a determination due to the nature of the business or the content of the financial statements.
- Individual income tax returns, signed and dated, plus all applicable schedules for the previous two years (or additional periods if needed to demonstrate a satisfactory earnings record).
- if the most recent year's tax return has not yet been prepared, provide a profit and loss statement for that year, and
- if the business is a corporation or partnership
  - copies of the signed federal business income tax returns for the previous two years plus all applicable schedules, and
  - a list of all stockholders or partners showing the interest each holds in the business
    Note: Obtain a written credit report on the business as well as the applicant as needed.

Analysis
Generally, income from self-employment is considered stable when the applicant has been in business for at least two years.

- Less than two years cannot usually be considered stable unless the applicant has had previous related employment and/or extensive specialized training.
- Less than one year can rarely qualify.
  In-depth development is required for a conclusion of stable income on less than one year cases.

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4.02 Income, Continued

Self-Employment Income (continued)

Analyze the general economic outlook for similar businesses to determine whether the business can be expected to generate sufficient income for the applicant's future needs.

If the business shows a steady or significant decline in earnings over the period analyzed, the reasons for such decline must be analyzed to determine whether the trend is likely to continue or be reversed.

If the business is unusual and it is difficult to determine the probability of continued operation, obtain an opinion on viability and future earnings, and an explanation of the function and financial operations of the business from a qualified party.

Depreciation claimed as a deduction on the tax returns and financial statements of the business may be included in effective income.

Active Military Applicant's Income

Verification

A military LES (Leave and Earnings Statement) is required instead of a VOE (VA Form 26-8497).

- The LES must furnish the same information as a VOE.
- The LES must be no more than 120 days old (180 days for new construction).
- For loans closed automatically, the date of the LES must be within 120 days of the date the note is signed (180 days for new construction).
- For prior approval loans, the date of the LES must be within 120 days of the date the application is received by VA (180 days for new construction).

The LES must be an original or a copy certified by the lender to be a true copy of the original.

In addition, identify service members who are within 12 months of release from active duty or end of contract term. Find the date of expiration of the applicant's current contract for active service on the LES (for an enlisted service member) or on an officer's orders. For a National Guard or Reserve member, find the expiration date of the applicant's current contract.

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4.02 Income, Continued

Active Military Applicant's Income (continued)

Verification (continued)

If the date is within 12 months of the anticipated date that the loan will close, the loan package must also include one of the following four items, or combinations of items, to be acceptable:

- Documentation that the service member has already reenlisted or extended his/her period of active duty to a date beyond the 12 month period following the projected closing of the loan, or
- verification of a valid offer of local civilian employment following the release from active duty. All data pertinent to sound underwriting procedures (date employment will begin, earnings, and so on) must be included, or
- a statement from the service member that he/she intends to reenlist or extend his/her period of active duty to a date beyond the 12 month period, plus
- a statement from the service member's commanding officer confirming that:
  - the service member is eligible to reenlist or extend his/her active duty as indicated, and
  - the commanding officer has no reason to believe that such reenlistment or extension of active duty will not be granted**,** or
- documentation of other unusually strong positive underwriting factors, such as:
  - a down payment of at least 10 percent
  - significant cash reserves, and
  - clear evidence of strong ties to the community coupled with a nonmilitary spouse's income so high that only minimal income from the active duty service member is needed to qualify.

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4.02 Income, Continued

Active Military Applicant's Income (continued)

Analysis: Base Pay
Consider the applicant's base pay as stable and reliable except if the applicant is within 12 months of release from active duty:

- Analyze the additional documentation submitted.
- If the applicant will not be reenlisting, determine whether
  - the applicant's anticipated source of income is stable and reliable, and/or
  - unusually strong underwriting factors compensate for any unknowns regarding future sources of income.

Verification: Military Quarters Allowance
To use a military quarters allowance in the underwriting analysis, obtain:

- *DD Form 1747, Status of Housing Availability,* indicating that item b (Permanent) or item d of that form apply. This form serves as notice that:
  - Quarters will not be made available to the applicant, and
  - the applicant is authorized to make permanent arrangements for nonmilitary housing.

Except DD Form 1747 is not required in either of the following circumstances:

- When the applicant's duty assignment clearly qualifies the applicant for quarters allowance.

  Examples include personnel stationed overseas whose families remain stateside, recruiters on detached duty, and military personnel stationed in areas where no on-base housing exists.
- When VA has established that the waiting lists for on-base housing in a particular geographic area are so long that it is improbable that individuals desiring to purchase off-base housing would be precluded from doing so in the foreseeable future.
- VA issues a release to all lenders in the jurisdiction to inform them of its determination.

Include an explanation with the loan submission of the circumstances justifying omission of the form.

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4.02 Income, Continued

Active Military Applicant's Income (continued)

Analysis: Military Quarters Allowance
The lender may include a military quarters allowance in effective income if properly verified. In most areas there will be an additional variable housing allowance, which can also be included.

- The military quarters and variable housing allowances are **not** taxable income.
- Ensure that the applicant meets the occupancy requirements set forth in Section 3.05.

Verification: Subsistence and Clothing Allowances
Any subsistence (rations) and clothing allowances are indicated on the LES.

Analysis: Subsistence and Clothing Allowances
The lender may include verified allowances in effective income. These allowances are not taxable income.

Note: The clothing allowance generally appears on the LES as an annual amount. Convert it to a monthly amount for the loan analysis.

Verification: Other Military Allowances
To consider a military allowance in the underwriting analysis, obtain verification of the type and amount of the military allowance, and how long the applicant has received it.

Analysis: Other Military Allowances
Examples include propay, flight or hazard pay, overseas pay and combat pay.

- All of these are subject to periodic review and/or testing of the recipient to determine continued eligibility.
- These types of allowances are considered taxable income by the IRS, unlike housing, clothing and subsistence allowances.

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4.02 Income, Continued

Active Military Applicant's Income (continued)

Military allowances may be included in effective income only if such income can be expected to continue because of the nature of the recipient's assigned duties.

Example: Flight pay verified for a pilot.

If duration of the military allowance cannot be determined, this source of income may still be used to offset obligations of 10 to 24 months duration.

Income from Service in the Reserves or National Guard

Income derived from service in the Reserves or National Guard may be included in effective income if the length of the applicant's total active and Reserve/Guard service indicates a strong probability that the Reserve/Guard income will continue.

Otherwise, this income may be used to offset obligations of 10 to 24 months duration.

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4.02 Income, Continued

Income of Recently Discharged Veterans

Verification
Obtain verification of any of the following which apply:

- Employment income
  Reference: See "Income from Non-Military Employment" in this section for verification requirements
- retirement income, and
- military separation payments.

If the applicant has been employed in a position for only a short time, obtain a statement from the employer that the applicant is performing the duties of the job satisfactorily and the probability of continued employment is favorable.

Analysis: Prospects for Continued Employment
Cases involving recently discharged veterans often require the underwriter to exercise a great deal of flexibility and judgment in determining whether the employment income will continue in the foreseeable future. This is because some veterans may have little or no employment experience other than their military occupation. Continuity of employment is essential for a veteran with no retirement income or insufficient retirement income to support the loan obligation.

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4.02 Income, Continued

Income of Recently Discharged Veterans (continued)

Analysis: Prospects for Continued Employment (continued)
For recently discharged veterans who have been in their new jobs only a very short time, analyze prospects for continued employment as follows:

- If the duties the applicant performed in the military are similar or directly related to the duties of the present position, use this as one indicator that the employment is likely to continue.
- If the applicant's current job requires skills for which the applicant has had no training or experience, greater time in the current job may be needed to establish stability.

If the applicant's retirement income, compared to total estimated shelter expense, long-term debts and family living expense, is such that only minimal income from employment is necessary to qualify from the income standpoint, resolve doubt in favor of the applicant.

Examples:
- <u>Qualifying short-term employment</u> - An applicant who was an airplane mechanic in the military is now employed as an auto mechanic or machinist.
- <u>Nonqualifying short-term employment</u> - An applicant who was an Air Force pilot is now employed as an insurance salesperson on commission.

Most cases fall somewhere between these extremes. Fully develop the facts of each case in order to make a determination.

Apply the guidelines under "Self-Employment Income" in this section to a recently discharged veteran who is self-employed.

Analysis: Voluntary Separation Payments
Two types of voluntary separation payments are used to facilitate military downsizing:

(1) *Special Separation Benefit (SSB)*

- A one-time lump sum
- Taxable in the year received, and
- Treat the same as any substantial cash reserve.

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4.02 Income, Continued

Income of Recently Discharged Veterans (continued)

Analysis: Voluntary Separation Payments (continued)

(2) *Voluntary Separation Incentive (VSI)*

- Annual payments
- Taxable in the year received
- Include in effective income
- Calculated by multiplying the veteran's years of service times two
- Requires a minimum of six years service (equates to a minimum of 12 years annual payments).

If the veteran receives both VSI and VA disability compensation payments, the VSI is reduced by the amount of disability compensation. However, if the disability compensation is related to an earlier period of service and the VSI a later period of service, the VSI is **not** reduced by the amount of disability compensation.

- VSI is reduced by the amount of any base pay or compensation a member receives for active or reserve service, including inactive duty training.
- The veteran can designate a beneficiary for VSI payments in the event of death.

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4.02 Income, Continued

Rental Income

Verification: Multi-Unit Property Securing the VA Loan
Verify
- cash reserves totaling at least 6 months mortgage payments (principal, interest, taxes, and insurance - PITI), and
- documentation of the applicant's prior experience managing rental units or other background involving both property maintenance and rental.

Analysis: Multi-Unit Property Securing the VA Loan
Include the prospective rental income in effective income only if

- evidence indicates the applicant has a reasonable likelihood of success as a landlord, and
- cash reserves totaling at least six months mortgage payments are available.

The amount of rental income to include in effective income is based on 75 percent of

- verified prior rent collected on the units (existing property), or
- the appraiser's opinion of the property's fair monthly rental (proposed construction).

Note: A percentage greater than 75% may be used if the basis for such percentage is adequately documented.

Verification: Rental of the Property Applicant Occupied Prior to the New Loan
Obtain a copy of the rental agreement on the property, if any.

Analysis: Rental of the Property Applicant Occupied Prior to the New Loan
Use the prospective rental income only to offset the mortgage payment on the rental property and only if there is no indication that the property will be difficult to rent. This rental income may **not** be included in effective income.

Obtain a working knowledge of the local rental market. If there is no lease on the property, but the local rental market is very strong, the lender may still consider the prospective rental income for offset purposes.

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4.02 Income, Continued

Rental Income (continued)

Verification: Rental of Other Property Not Securing the VA Loan
Obtain

- documentation of cash reserves totaling at least three months mortgage payments (principal, interest, taxes, and insurance - PITI), and
- individual income tax returns, signed and dated, plus all applicable schedules for the previous two years, which show rental income generated by the property.

Analysis: Rental of Other Property Not Securing the VA Loan
Rental income verified as stable and reliable may be included in effective income.

If there is little or no prior rental history on the property, make a determination based on review of

- documentation of the applicant's prior experience managing rental units or other background involving both property maintenance and rental
- any leases on the property, and
- the strength of the local rental market.

Property depreciation claimed as a deduction on the tax returns may be included in effective income.

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4.02 Income, Continued

Alimony, Child Support, and Maintenance Payments

See “ECOA Considerations” in this section.

Verify the income if the applicant wants it to be considered. The payments must be likely to continue in order to include them in effective income.

Factors used to determine whether the payments will continue include, but are not limited to

- whether the payments are received pursuant to a written agreement or court decree
- the length of time the payments have been received
- the regularity of receipt, and
- the availability of procedures to compel payment.

Automobile or Similar Allowances

Generally, automobile allowances are paid to cover specific expenses related to an applicant’s employment, and it is appropriate to use such income to offset a corresponding car payment.

However, in some instances, such an allowance may exceed the car payment. With proper documentation, income from a car allowance which exceeds the car payment can be counted as effective income. Likewise, any other similar type of allowance which exceeds the specific expenses involved may be added to gross income to the extent it is documented to exceed the actual expense.

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4.02 Income, Continued

Other Types of Income

If it is reasonable to conclude that other types of income will continue in the foreseeable future, include it in effective income. Otherwise, consider whether it is reasonable to use the income to offset obligations of 10 to 24 months duration.

"Other" types of income which may be considered as effective income include, but are not limited to

- pension or other retirement benefits
- disability income
- dividends from stocks
- interest from bonds, savings accounts, and so on, and
- royalties.

The lender may include verified income from public assistance programs in effective income if evidence indicates it will probably continue for three years or more.

The lender may include verified workers' compensation income that will continue in the foreseeable future, if the veteran chooses to reveal it.

The lender may include verified income received specifically for the care of any foster child(ren). Generally, however, foster care income is to be used only to balance the expenses of caring for the foster child(ren) against any increased residual income requirements.

Do **not** include temporary income items such as VA educational allowances and unemployment compensation in effective income.

Exception:
If unemployment compensation is a regular part of the applicant's income due to the nature of his or her employment (for example, seasonal work), it may be included.

4.03 Income Taxes and Other Deductions from Income

Income Tax and Social Security Deductions

Determine the appropriate deductions for Federal income tax and Social Security using the "Employer's Tax Guide," Circular E, issued by the Internal Revenue Service.

Determine the appropriate deductions for state and local taxes using similar materials provided by the states.

The lender may consider the applicant's potential tax benefits from obtaining the loan (for example, mortgage interest deduction) in the analysis. To do so,

- determine what the applicant's withholding allowances will be, using the instructions and worksheet portion of IRS Form W-4, Employee's Withholding Allowance Certificate, and
- apply that withholding number when calculating Federal and state income tax deductions.

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4.03 Income Taxes and Other Deductions from Income,
Continued

Income Tax Credits from Mortgage Credit Certificates

Mortgage Credit Certificates (MCCs) issued by state and local governments may qualify a borrower for a Federal tax credit. The Federal tax credit is based on a certain percentage of the borrower's mortgage interest payment.

Lenders must provide a copy of the MCC to VA with the loan package which indicates

- the percentage to be used to calculate the tax credit, and
- the amount of the certified indebtedness.
  The certified indebtedness can be comprised of a loan incurred by the veteran to acquire a principal residence or a qualified home improvement or rehabilitation loan.

If the percentage on the MCC is more than 20%, there is an annual limit on the tax credit equal to the lesser of $2,000 or the borrower's maximum tax liability. Calculate the tax credit by applying the specified percentage to the interest paid on the certified indebtedness. Then apply the annual limit.

Example: The MCC shows a 30 percent rate and $100,000 certified indebtedness. The borrower will pay approximately $8,000 in annual mortgage interest. Borrower's estimated total Federal income tax liability is $9,000. Calculate the tax credit as follows:

- 30% of $8,000 = $2,400
- Apply the annual $2,000 limit
- The tax credit will be $2,000
- Use $167 (one-twelfth of $2,000) in the monthly analysis.

Note: If the mortgage on which the borrower pays interest is greater than the amount of certified indebtedness, limit the interest used in the tax credit calculation to that portion attributable to the certified indebtedness.

4.04 Assets

Amount of Cash Required

The applicant or spouse must have sufficient cash to cover

- any closing costs or points which are the applicant's responsibility and are not financed in the loan
- the down payment, if a Graduated Payment Mortgage, and
- the difference between the sales price and the loan amount, if the sales price exceeds the reasonable value established by VA.

VA does **not** require the applicant to have additional cash to cover a certain number of mortgage payments, unplanned expenses, or other contingencies.

However, the applicant's ability to accumulate liquid assets and the current availability of liquid assets for unplanned expenses should be considered in the overall credit analysis.

Verification Requirement

Verify all liquid assets owned by the applicant or spouse to the extent they are needed to close the loan. In addition, verify any liquid assets that may have a bearing on the overall credit analysis; that is, significant assets.

- Use VA Form 26-8497a, Request for Verification of Deposit, as appropriate.
  Acceptable alternative documentation is the original or certified true copies of the applicant's last two bank statements.
- Verifications must be no more than 120 days old (180 days for new construction).
  - For automatically closed loans, this means the date of the deposit verification is within 120 days of the date the note is signed (180 days for new construction).
  - For prior approval loans, this means the date of the deposit verification is within 120 days of the date the application is received by VA (180 days for new construction).

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4.04 Assets, Continued

Pending Sale of Real Estate

In some cases, the determination that the income and/or assets of a veteran are sufficient to qualify for the loan depends upon the consummation of the sale of presently owned real property.

- Sales proceeds may be necessary to make a down payment or pay closing costs on the VA loan.
- In addition, the lender may want to consider the amount of equity the applicant has accumulated in the property and the extent to which that equity is attributable to the applicant's investment rather than the housing market, in evaluating the applicant's ability to manage assets.

The lender may consider any down payment or costs on the VA loan as provided for by the sale of the property if available information provides a reasonable basis for concluding the equity to be realized from the sale will be sufficient for this purpose.

References:
- See Section 5.04 for prior approval loans which depend upon the sale of property for the borrower to qualify.
- See Section 5.06 for required loan closing documents.

4.05 Debts and Obligations

Verification

Significant debts and obligations of the applicant must be verified and rated.

Obtain a credit report.

Reference: See Section 4.07 for details on the type of credit report required.

For obligations not included on the credit report which are revealed on the application or through other means, the lender must obtain a verification of deposit showing the obligation or other written verification directly from the creditor. The lender must also separately verify accounts listed as “will rate by mail only” or “need written authorization.”

When a pay stub or leave-and-earnings statement indicates an allotment, the lender must investigate the nature of the allotment to determine whether the allotment is related to a debt.

For obligations that have not been rated on the credit report or elsewhere, obtain the verification and rating directly from the creditor. Include a written explanation for any obligation that is not rated.

Resolve all discrepancies. If the credit report or deposit verification reveals significant debts or obligations which were not divulged by the applicant

- obtain clarification as to the status of such debts from the applicant, then
- verify any remaining discrepancies with the creditor.

Credit reports and verifications must be no more than 120 days old (180 days for new construction).

- For automatically closed loans, this means the date of the credit report or verification is within 120 days of the date the note is signed (180 days for new construction).
- For prior approval loans, this means the date of the credit report or verification is within 120 days of the date the application is received by VA (180 days for new construction).

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4.05 Debts and Obligations, Continued

Verification (continued)

ECOA prohibits requests for, or consideration of, credit information on a spouse who will not be contractually obligated on the loan except

- if the applicant is relying on alimony, child support, or maintenance payments from the spouse (or former spouse), or
- in community property states.

  If the property is located in a community property state, VA requires consideration of the spouse's credit information (whether or not the spouse will be personally liable on the note and whether or not the applicant and spouse choose to have the spouse's income considered).

Verification of Alimony and Child Support Obligations

The payment amount on any alimony and/or child support obligation of the applicant **must** be verified.

Do **not** request documentation of an applicant's divorce unless it is necessary to verify the amount of any alimony or child support liability indicated by the applicant. If, however, in the routine course of processing the loan, the lender encounters direct evidence (such as, in the credit report) that a child support or alimony obligation exists, make any inquiries necessary to resolve discrepancies and obtain the appropriate verification.

Continued on next page

4.05 Debts and Obligations, Continued

Analysis of Debts and Obligations

Deduct significant debts and obligations from total effective income when determining ability to meet the mortgage payments. Significant debts and obligations include

- debts and obligations with a remaining term of 10 months or more; that is, long-term obligations, and
- accounts with a term less than 10 months that require payments so large as to cause a severe impact on the family's resources for any period of time.

Example: Monthly payments of $300 on an auto loan with a remaining balance of $1,500, even though it should be paid out in five months, would be considered significant. The payment amount is so large as to cause a severe impact on the family's resources during the first, most critical, months of the home loan.

Determine whether debts and obligations which do **not** fit the description of "significant" should be given any weight in the analysis. They may have an impact on the applicant's ability to provide for family living expenses.

If a married veteran wants to obtain the loan in his or her name only, the veteran may do so without regard to the spouse's debts and obligations in a non-community property state. However, in community property states, the spouse's debts and obligations must be considered even if the veteran wishes to obtain the loan in his or her name only.

Debts assigned to an ex-spouse by a divorce decree will not generally be charged against a veteran-borrower. This includes debts that are now delinquent.

Continued on next page

4.05 Debts and Obligations, Continued

Applicant as Co-obligor on Another's Loan

The applicant may have a contingent liability based on co-signing a loan. If

- there is evidence that the loan payments are being made by someone else, and
- there is no reason to believe that the applicant will have to participate in repayment of the loan, then
- the lender may exclude the loan payments from the monthly obligations factored into the net effective income calculation in the loan analysis.

Pending Sale of Real Estate

In some cases, the determination that the income and/or assets of a veteran are sufficient to qualify for the loan depends upon the consummation of the sale of presently owned real property. Sales proceeds may be necessary to

- clear the outstanding mortgage(s) against the property
- pay off outstanding consumer obligations, and/or
- make a down payment or pay closing costs on the VA loan.

Alternatively, the veteran may intend to sell the property with the buyer assuming the outstanding mortgage obligation.

The lender may disregard the payments on the outstanding mortgage(s) and any consumer obligations which the veteran intends to clear if available information provides a reasonable basis for concluding the equity to be realized from the sale will be sufficient for this purpose.

References:
- See Section 5.04 for prior approval loans dependent upon the sale of property for the borrower to qualify.
- See Section 5.06 for required loan closing documents.

Continued on next page

4.05 Debts and Obligations, Continued

Secondary Borrowing

If the applicant plans to obtain a second mortgage simultaneously with the VA-guaranteed loan include the second mortgage payment as a significant debt.

Reference: See Section 9.04 for VA limitations on secondary borrowing.

From an underwriting standpoint, the veteran must **not** be placed in a substantially worse position than if the entire amount borrowed had been guaranteed by VA.

4.06 Required Search for and Treatment of Debts Owed to the Federal Government

The Search Requirement

There are two separate procedures the lender must follow. Both should be initiated immediately upon receipt of a loan application to avoid delays in closing the loan.

(1) Ask the veteran and any veteran co-obligors (including spouse if a veteran) if he or she

– is receiving VA disability benefits
– would be entitled to receive VA disability benefits but for the receipt of retired pay
– has received VA disability benefits in the past, or
– is a surviving spouse of a veteran who died on active duty or as a result of a service-connected disability.

If the veteran falls under one of the above categories, follow the procedures discussed under "Debt Related to VA Benefits" below.

(2) For all applicants and co-obligors (veteran or nonveteran) on all VA loans including Interest Rate Reduction Refinancing Loans (IRRRLs), perform a CAIVRS inquiry.

Reference: See "CAIVRS Procedures" in this section.

Debt Related to VA Benefits

Before processing a loan involving certain veterans, as described in item (1) of "The Search Requirement," the lender must submit VA Form 26-8937, Verification of VA Benefit-Related Indebtedness, to the VA office where the loan application and/or closed loan package will be sent. VA will complete and return the form to the lender.

- The loan cannot be submitted for prior approval or approved under the automatic procedure until the lender obtains the completed form from VA.
- The lender must submit the completed form with the loan package.

If the form indicates that the applicant receives nonservice-connected pension or has been rated incompetent by VA, the loan cannot be closed automatically. Submit the loan for prior approval.

Continued on next page

4.06 Required Search for and Treatment of Debts Owed to the Federal Government, Continued

Debt Related to VA Benefits (continued)

If the form indicates that the applicant has any of the following:

- An outstanding indebtedness of overpaid education, compensation or pension benefits
- an education or direct home loan in default
- an outstanding indebtedness resulting from payment of a claim on a prior guaranteed home loan,
- a repayment plan for any of these debts that is not current, then
- one of the following must accompany the loan package:
  - evidence of payment in full of the debt, or
  - evidence of a current repayment plan acceptable to VA and evidence that the veteran executed a promissory note for the entire debt balance.

Note: No promissory note is required in cases referred to the Department of Justice, General Accounting Office, or VA Regional Counsel for judicial enforcement. In such cases, VA will obtain information on the applicant's debt status from these parties and relay pertinent information to the lender.

VA may find a repayment plan acceptable if

- the veteran has been satisfactorily making payments on a repayment plan in effect prior to the lender's inquiry
- the veteran's overall credit history and anticipated financial capacity after the proposed loan is made indicate a reasonable likelihood that the repayment plan will be honored and the outstanding amount of indebtedness is not so large that it would prevent payment in full within a reasonable period (approximately one year), or
- the case involves unusually meritorious circumstances.

Example:
- Consideration would be given to a veteran with an outstanding credit history and adequate income whose debt balance is too large to be reasonably paid out in less than 18 months to two years.
- VA will offer special consideration to a veteran's claim that he or she was not previously aware of an overpayment of benefits.

Continued on next page

4.06 Required Search for and Treatment of Debts Owed to the Federal Government, Continued

What is CAIVRS?

CAIVRS is a HUD-maintained computer information system which enables participating lenders to learn when an applicant has previously defaulted on a federally-assisted loan. The system's interactive voice response function provides instant credit information.

The database includes default information from the Department of Agriculture, the Small Business Administration, the Department of Education, HUD, and VA.

The VA default information included in the database relates to

- overpayments on education cases
- overpayments on disability benefits income, and
- claims paid due to home loan foreclosures.

CAIVRS Procedures

VA assigns an 11-digit VA ID number to each new lender (See Section 1.13, Lender ID Numbers), then automatically forwards the ID number to HUD with a request to grant the lender CAIVRS access. The lender can begin accessing CAIVRS within several weeks of its VA ID number assignment.

Perform a CAIVRS screening on each applicant and any co-obligor immediately upon receipt of a loan application. This includes Interest Rate Reduction Refinancing loan applicants. Step-by-step instructions follow. (See also HUD Mortgagee Letter 92-31). HUD also offers direct online access to CAIVRS through "the FHA Connection." Contact HUD for details.

Step	Action
1	Call CAIVRS using a touch-tone telephone. Dial (301)-344-4000 Monday through Saturday 8:00 a.m. to 8:00 p.m. Eastern Time.
2	• You will hear, "Welcome to the HUD Voice Response System. To access the Credit Alert System, press 1. To access the Line of Credit Control System, press 2. If you have completed your call, press Zero. Thank you." • Enter 1.

Continued on next page

4.06 Required Search for and Treatment of Debts Owed to the Federal Government, Continued

CAIVRS Procedures (continued)

Step	Action
3	You will hear, "You have reached the HUD Credit Alert System. Please enter your credit alert access code and then press #." • Enter the first 10 digits of your VA lender ID number, then the "#" sign. • CAIVRS will only allow one second attempt to enter an access code. The session is terminated if the second attempt fails.
4	• If the lender is authorized to process more than one loan type, you will hear a menu. "If you are processing a HUD Title I loan, press 1, or if you are processing a FHA Single Family mortgage loan, press 2, or if you are processing a HUD 312 LPA, press 3, or if you are processing a Veterans Affairs loan, press 4, or if you are...(and so on),..then press #." • Enter 4, then "#".
5	• You will hear, "Please now enter applicant's Social Security Number and then press * OR the Tax Identification Number and then press #." • Enter the appropriate number and symbol.
6	You will hear, "You have entered Social Security Number ----- (repeat of number entered) or Tax Identification Number -----. Please enter 'Y' if this is correct, or 'N' if not correct." • Enter "Y" if correct. • If incorrect, enter "N" and repeat Step 5.

Continued on next page

4.06 Required Search for and Treatment of Debts Owed to the Federal Government, Continued

CAIVRS Procedures (continued)

Step	Action
7	If there is no match, you will hear, "There are no claims, foreclosures or defaults for this borrower." If there is a match, you will hear a message reciting: • The type of match (For example, "There is a foreclosure on this borrower.") • The case number (For example, "DVA default ----- ") • The point of contact referral message ("For information, please call area code --- --- ---- "). Copy down all pertinent information provided.
8	You will hear, "Credit Alert Confirmation Code is ----- ." Copy down the confirmation code for future identification of the particular inquiry.
9	You will hear, "If you would like the access information repeated, press 1, or if you would like to enter another applicant for the same type of loan, press 2, or for a different type of loan press 3." • Enter 1 (to have the applicant's information repeated) or • enter 2 (then return to Step 5) or • enter 3 (then return to Step 4) or • hang up (if you are finished).
10	If you remain on the line you will hear, "To return to the main menu press zero. If call completed, you may hang up now. Thank you for using the HUD Voice Response System." • Enter O, or • hang up.

Continued on next page

4.06 Required Search for and Treatment of Debts Owed to the Federal Government, Continued

CAIVRS Procedures (continued)

Step	Action
11	• Enter the CAIVRS confirmation code on VA Form 26-6393, Loan Analysis, as evidence the screening was performed. • Enter the code in the space to the right of the "NO" block in item 47. • For IRRRLs, enter the CAIVRS confirmation code on VA Form 26-8923, IRRRL Worksheet, beside the word "Note" which is located near the bottom of the form.

Applicant Presently Delinquent

If the CAIVRS screening indicates an applicant (or coobligor) is presently delinquent or has had a foreclosure or a claim paid on a loan made, guaranteed or insured by a Federal agency, take the following actions:

Step	Action
1	Suspend processing of the loan application.
2	Contact the applicant or coobligor for information regarding the loan default, foreclosure or claim. If a previous VA loan is involved, the applicant may call 1-800-827-0648 to make arrangements to repay the debt.
3	• Contact the Federal agency that reported the applicant to CAIVRS if further information is needed. • Use the phone number provided by CAIVRS (Step 7 in the previous table).
4	If the CAIVRS-provided point of contact does **not** provide a satisfactory solution, or if the applicant believes the CAIVRS information is erroneous, the lender must contact the agency point(s) of contact in the following list.

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4.06 Required Search for and Treatment of Debts Owed to the Federal Government, Continued

Applicant Presently Delinquent (continued)

Program to Which the Default Relates	Contact
HUD Title I	The local Title I Debt Management Centers
HUD Title II	The local HUD field offices
Section 312 loans	Department of Housing & Urban Development Rehabilitation Loans and Homesteading Division 451 Seventh Street, SW Room 7168 Washington, DC 20410 Telephone: 202-898-1000 REFER TO CAIVRS INFORMATION
SBA loans	Small Business Administration Operations Assistance Branch 409 Third Street, SW Washington, DC 20416 Telephone: 202-205-6481
USDA loans	USDA/Rural Housing Service Quality Assurance Branch 1520 Market St., FC-351, Room 3519 St. Louis, MO 63103 Telephone: 314-539-2492
DVA loans	Department of Veterans Affairs Debt Management Center Bishop Henry Whipple Federal Bldg., Fort Snelling St. Paul, MN 55111 Telephone: 1-800-827-0648
Education loans	The Education Regional Offices

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4.06 Required Search for and Treatment of Debts Owed to the Federal Government, Continued

Applicant Presently Delinquent (continued)

Give full consideration to the CAIVRS information, and any subsequent clarifying information provided, in applying VA credit standards.

- Consider the terms of any repayment plan in analyzing monthly debt payments.
- Consider any delinquencies in determining creditworthiness.

CAIVRS information is only for the lender's and applicant's use in processing the loan application. Only those persons having responsibility for screening applicants and/or co-obligors may use CAIVRS. **Any other use is unauthorized**.

Treatment of Federal Debts

An applicant cannot be considered a satisfactory credit risk if he or she is presently delinquent or in default on any debt to the Federal Government until the delinquent account has been brought current or satisfactory arrangements have been made between the applicant and the Federal agency. The refinancing of a delinquent VA loan with an IRRRL satisfies this requirement.

An applicant cannot be considered a satisfactory credit risk if he or she has a judgment lien against his or her property for a debt owed to the Government until the judgment is paid or otherwise satisfied.

4.07 Credit History

Credit Report Standards

Credit reports used in analyzing VA loans must be either:

- Three-file Merged Credit Reports (MCR), or
- Residential Mortgage Credit Reports (RMCR).

The credit report must be less than 120 days old (180 days for new construction).

- For automatically closed loans, the date of the credit report must be within 120 days of the date the note is signed (180 days for new construction).
- For prior approval loans, the date of the credit report must be within 120 days of the date the application is received by VA (180 days for new construction).

If an RMCR is Used
The standards applicable to an RMCR include, but are not limited to, the following:

- The report must be prepared by a reputable credit reporting agency.
- Each account with a balance must have been checked with the creditor within 90 days of the date of the credit report.
- For each debt listed, the report must provide the creditor's name, date the account was opened, high credit, current status, required payment, unpaid balance, and payment history.
- The report must name at least two national repositories of credit records contacted for each location in which the borrower has resided during the most recent two years.

  Separate repository inquiries are required for any coborrowers with individual credit records.
- The report must include all available public records information that is not considered obsolete under the Fair Credit Reporting Act; such as bankruptcies, judgments, law suits, foreclosures and tax liens.
- The RMCR must be an original report, with no erasures, whiteouts, or alterations.
- The report must contain a 24 month employment and residency history.
- All inquiries made within the last 90 days must be included on the report.

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4.07 Credit History, Continued

Credit Report Standards (continued)

VA may decline to accept a credit report which does not meet these standards.

VA will notify the lender and the credit reporting agency of how quality standards are not being met. If the problem continues, VA will inform all participating lenders that credit reports from the particular credit reporting agency are unacceptable.

Verification and Rating of Debts and Obligations

See Section 4.05 for requirements of verification.

How to Analyze Credit

The applicant's past repayment practices on obligations are the best indicator of his or her willingness to repay future obligations. Emphasis should be on the applicant's overall payment patterns rather than isolated occurrences of unsatisfactory repayment. Determine whether the applicant (and spouse, if applicable) are satisfactory credit risks based on a careful analysis of the credit report and other credit data.

Rent and Mortgage Payment History
The applicant's rental history and any outstanding, assumed, or recently retired mortgages must be verified and rated.

Housing expense payment history is often the best indicator of how motivated the applicant is to make timely mortgage payments in the future.

Absence of Credit History
For applicants with no established credit history, base the determination on the applicant's payment record on utilities, rent, automobile insurance, or other expenses that applicant has paid.

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4.07 Credit History, Continued

How to Analyze Credit (continued)

Absence of a credit history is **not** generally considered an adverse factor. It may result when

- recently discharged veterans have not yet developed a credit history
- applicants have routinely used cash rather than credit, and/or
- applicants have not used credit since some disruptive credit event such as bankruptcy or debt pro-ration through consumer credit counseling.
  In these cases, develop evidence of timely payment of noninstallment obligations such as rent and utilities since the disruptive credit event.

  Reference: For bankruptcy cases, see "Bankruptcy" in this section.

Accounts in the Spouse's Name
Under ECOA—Upon the applicant's request, the lender must consider any account reported in the name of the applicant's spouse or former spouse that the applicant can demonstrate accurately reflects the applicant's creditworthiness.

Consideration of the Spouse's Credit History
ECOA prohibits requests for, or consideration of, the credit of a spouse who will not be contractually obligated on the loan except

- if the applicant is relying on alimony, child support, or maintenance payments from the spouse (or former spouse), or
- in community property states.
  - If the property is located in a community property state, VA requires consideration of the spouse's credit (whether or not the spouse will be personally liable on the note and whether or not the applicant and spouse choose to have the spouse's income considered).
  - If a married veteran wants to obtain the loan in his or her name only, the veteran may do so without regard to the spouse's credit only in a non-community property state.

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4.07 Credit History, Continued

How to Analyze Credit (continued)

Adverse Data

In circumstances not involving bankruptcy, satisfactory credit is generally considered to be reestablished after the veteran, or veteran and spouse, have made satisfactory payments for 12 months after the date of the last derogatory credit item.

If the applicant and/or spouse are determined satisfactory credit risks in spite of derogatory credit information, include an explanation of the basis for the determination.

For unpaid debts or debts that have not been paid timely pay-off of these debts after the acceptability of applicant's credit is questioned does **not** alter the unsatisfactory record of payment.

Lenders may consider a veteran's claim of bona fide or legal defenses regarding unpaid debts except when the debt has been reduced to judgment.

Collection accounts do not necessarily have to be paid off as a condition for loan approval. Account balances reduced to judgment by a court must either be paid in full or subject to a repayment plan with a history of timely payments.

Consumer Credit Counseling Plan

If a veteran, or veteran and spouse, have prior adverse credit and are participating in a Consumer Credit Counseling plan, they may be determined to be a satisfactory credit risk if they demonstrate 12 months' satisfactory payments and the counseling agency approves the new credit.

If a veteran, or veteran and spouse, have good prior credit and are participating in a Consumer Credit Counseling plan, such participation is to be considered a neutral factor, or even a positive factor, in determining creditworthiness. Do not treat this as a negative credit item if the veteran entered the Consumer Credit Counseling plan before reaching the point of having bad credit.

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4.07 Credit History, Continued

Bankruptcy

The fact that a bankruptcy exists in an applicant's (or spouse's) credit history does **not** in itself disqualify the loan. Develop complete information on the facts and circumstances of the bankruptcy. Consider the reasons for the bankruptcy and the type of bankruptcy filing.

Bankruptcy Filed Under the Straight Liquidation and Discharge Provisions of the Bankruptcy Law

You may disregard a bankruptcy discharged more than two years ago.

If the bankruptcy was discharged within the last one to two years, it is probably **not** possible to determine that the applicant or spouse is a satisfactory credit risk unless both of the following requirements are met:

- The applicant or spouse has obtained consumer items on credit subsequent to the bankruptcy and has satisfactorily made the payments over a continued period, and
- the bankruptcy was caused by circumstances beyond the control of the applicant or spouse such as unemployment, prolonged strikes, medical bills not covered by insurance, and so on, and the circumstances are verified. Divorce is **not** generally viewed as beyond the control of the borrower and/or spouse. If the bankruptcy was caused by failure of the business of a self-employed applicant, it may be possible to determine that the applicant is a satisfactory credit risk if
  - the applicant obtained a permanent position after the business failed
  - there is no derogatory credit information prior to self-employment
  - there is no derogatory credit information subsequent to the bankruptcy, and
  - failure of the business was **not** due to the applicant's misconduct.

If a borrower or spouse has been discharged in bankruptcy within the past 12 months, it will **not** generally be possible to determine that the borrower or spouse is a satisfactory credit risk.

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4.07 Credit History, Continued

Bankruptcy (continued)

Petition Under Chapter 13 of the Bankruptcy Code
This type of filing indicates an effort to pay creditors. Regular payments are made to a court-appointed trustee over a two to three year period or, in some cases, up to five years, to pay off scaled down or entire debts.

If the applicant has finished making all payments satisfactorily, the lender may conclude that the applicant has reestablished satisfactory credit.

If the applicant has satisfactorily made at least 12 months' worth of the payments and the Trustee or the Bankruptcy Judge approves of the new credit, the lender may give favorable consideration.

Foreclosures

The fact that a home loan foreclosure (or deed-in-lieu of foreclosure) exists in an applicant's (or spouse's) credit history does **not** in itself disqualify the loan.

- Develop complete information on the facts and circumstances of the foreclosure.
- Apply the guidelines provided for bankruptcies filed under the straight liquidation and discharge provisions of the bankruptcy law. See the preceding heading entitled "Bankruptcy."

If the foreclosure was on a VA loan, the applicant may not have full entitlement available for the new loan. Ensure that the applicant's Certificate of Eligibility reflects sufficient entitlement to meet any secondary marketing requirements of the lender.

4.08 Documentation for Automated Underwriting Cases

General

VA has approved Freddie Mac's Loan Prospector, Fannie Mae's DU (and the pmiAura System for VA), and the CLUES System (for use with loans originated by Countrywide) automated underwriting systems (AUS) for use in connection with VA guaranteed home loans. These systems incorporate VA's credit standards and processing requirements.

Lenders may use certain reduced documentation requirements on cases processed with approved AUSs. The level of reduced documentation depends on the risk classification assigned. The systems use slightly different terminology such as Approve or Accept. The tables in this section give a general description of documentation waivers. Please note that the documentation requirements are the same for these cases as for non-AUS cases, except for any differences cited in the tables.

Lenders must maintain a copy of the AUS feedback certificate (or equivalent) with their origination package.

Underwriter's Certification

Because the Loan Prospector system will be making the determination that the loan satisfies credit and income requirements, cases receiving an "Accept" rating will not require the underwriter's certification on VA Form 26-6393, Loan Analysis (items 50 through 54). Instead, lenders will need to complete the following certification on "Accept" loans:

"I, the undersigned lender, hereby certify that case number (insert VA loan number) was processed through ________________ and received an 'Accept' rating. I further certify that all information entered into the system has been verified and that any credit discrepancies have been reconciled."

This certification must be signed by a representative of the lender and submitted along with a copy of the AUS Feedback Certificate indicating the risk classification.

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4.08 Documentation for Automated Underwriting Cases, Continued

Documentation Guidelines For Credit History

Refer to the following table for Documentation guidelines for credit history.

Subject and Reference	Documentation Classification	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept**
Types of credit reports used in reconciliation (Section 4.07)	Use either of the following, if ≤90 days old: • Merged credit report • RMCR	Use any of the following, if ≤90 days old: • Selected in-file report • All in-file reports • Merged credit report • RMCR
Explanation of discrepancies in reported debt (Section 4.05)	Provide written explanation for any single debt >2% of gross monthly income which appears on the credit report but is not listed on the application.	No explanation is required.
Verification of significant nonmortgage debt (Section 4.05)	Obtain direct verification for significant debts not reported on the credit report. ***Note***: Significant means that the debt has a monthly payment exceeding 2% of the stable monthly income for all borrowers.	Same as Refer. ***Note***: Perform manual downgrade to Refer if direct verification reveals more than 1x30 day late payment in the past 12 months for any of the omitted debts.

Continued on next page

4.08 Documentation for Automated Underwriting Cases,
Continued

Documentation Guidelines For Credit History (continued)

Subject and Reference	Documentation Classification	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept**
Mortgage payment history (Section 4.07)	Obtain direct verification when ratings are not available on mortgages that are any of the following: • Outstanding • Assumed • Recently retired A written explanation of mortgage payment history is required for borrowers with more than 1x30 day late payment for all mortgages for the past 12 months.	Obtain direct verification when ratings are not available on mortgages that are any of the following: • Outstanding • Assumed • Recently retired ***Note***: Perform manual downgrade to Refer if direct verification reveals more than 1x30 day late payment in the past 12 months for any mortgage debts.
Account balances (Section 4.07)	No re-verification is required for an account with an outstanding balance last updated <90 days before the date of the credit report, unless the account has a past due current status.	Same as Refer.
Rental payment history (Section 4.07)	Provide a written explanation when ratings are not available on the applicant's rental payment history.	No verification of rent is required when a minimum of four credit references is reported for all borrowers, each open for at least four years.
Derogatory credit information (Section 4.07)	Explain basis of satisfactory credit risk determination in spite of derogatory credit information in the Remarks section of VA Form 26-6393, Loan Analysis.	No explanation is required for adverse or derogatory credit information.

Continued on next page

4.08 Documentation for Automated Underwriting Cases,
Continued

Documentation Guidelines For Credit History (continued)

Subject and Reference	**Documentation Classification**	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept**
Employment gaps (Section 4.02)	No explanation for employment gaps is required if the gaps are <30 days.	No explanation for employment gaps is required if all of the following conditions are met: • Gaps are <60 days • New employment is $\geq$6 months.
Alimony and/or child support payments (Section 4.02)	Provide the following: • Proof of deposits on bank statements for three months • Front page and details of support payments from the divorce decree, indicating evidence of at least three years continuance	Same as Refer.

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4.08 Documentation for Automated Underwriting Cases,
Continued

Documentation Guidelines for Borrowers-Not Self Employed

Refer to the following table for documentation guidelines for employment/income for borrowers who are not self-employed.

Subject and Reference	Documentation Classification	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept**
Verifying current employment for borrowers who are not self-employed (Section 4.02)	Document telephone contact verifying borrower's current employer. Use only one current pay stub (versus pay stubs for one month) provided that it covers at least one full month of employment and contains the following: • Year-to-date (YTD) information • Bonus information • Overtime information	Same as Refer.

Continued on next page

4.08 Documentation for Automated Underwriting Cases,
Continued

Documentation Guidelines for Borrowers-Not Self Employed (continued)

Subject and Reference	**Documentation Classification**	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept**
Verifying previous employment (Section 4.02)	Use a Verification of Employment (VOE) or any of the following, covering the two year period prior to closing: • W-2 Forms • Income information obtained from the IRS via one of the following forms: – Form 8821 (or alternate form acceptable to the IRS that collects comparable information) – Form 4506 (or alternate form acceptable to the IRS that collects comparable information)	No VOE is required if the borrower has been with the same employer for one year and W-2 Forms for one previous year have been collected. • No W-2 Forms are required for a borrower on active duty. • No W-2 Forms are required if all of the following are met: – Borrower with same employer ≥2 years – Employer phone contact verifies the length of employment and current status (still employed) – Borrower not self-employed or commissioned – Bonus, overtime, or secondary income not needed to qualify – Stable monthly income to be determined by using current base pay only (rather than total earnings) – Borrower signs one of the following for the previous two tax years: - Form 8821, and - Form 4506.

Continued on next page

4.08 Documentation for Automated Underwriting Cases, Continued

Documentation Guidelines for Borrowers-Self Employed

Refer to the following table for documentation guidelines for employment/income for borrowers who are self-employed.

Subject and Reference	Documentation Classification	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept**
Individual tax returns for self-employed borrowers (Section 4.02)	Provide one of the following, with all line items captured: • Signed copies of individual tax returns for the most recent two year period • Individual income information obtained from the IRS via one of the following forms: – Form 8821 (or an alternate form acceptable to the IRS that collects comparable information) – Form 4506 (or an alternate form acceptable to the IRS that collects comparable information)	Same as Refer.

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4.08 Documentation for Automated Underwriting Cases,
Continued

Documentation Guidelines for Borrowers-Self Employed (continued)

<table>
<tr><th rowspan="2">Subject and Reference</th><th colspan="2">Documentation Classification</th></tr>
<tr><th>Documentation Guidelines and Reductions for Refer</th><th>Additional Documentation Reductions for Accept</th></tr>
<tr><td>Balance sheets and profit and loss statements for self-employed borrowers (Section 4.02)</td><td>No balance sheet or YTD Profit and Loss (YTD P&L) is required if any of the following occur:

• Individual and business income information is obtained from the IRS prior to closing, via one of the following forms:
– Form 8821 (or alternate form acceptable to the IRS that collects comparable information)
– Form 4506 (or alternate form acceptable to the IRS that collects comparable information)
• Origination date is ≤ seven months from the business’ fiscal year end (for which tax returns were provided)
• Borrower is a de minimus self-employed borrower</td><td>No balance sheet or YTD P&L is required.</td></tr>
</table>

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4.08 Documentation for Automated Underwriting Cases,
Continued

Documentation Guidelines for Borrowers-Self Employed (continued)

<table>
<tr><th rowspan="2">Subject and Reference</th><th colspan="2">Documentation Classification</th></tr>
<tr><th>Documentation Guidelines and Reductions for Refer</th><th>Additional Documentation Reductions for Accept</th></tr>
<tr><td>Business tax returns for self-employed borrowers (Section 4.02)</td><td>Provide one of the following, with all line items captured:

• Signed copies of business tax returns for the most recent two year period
• Business income information obtained from the IRS via one of the following forms:
– Form 8821 (or an alternate form acceptable to the IRS that collects comparable information)
– Form 4506 (or an alternate form acceptable to the IRS that collects comparable information)</td><td>No business tax returns are required if all of the following conditions are met:

• Borrower proves ownership of the business for at least the past five years.
• Individual tax returns reflect consistent income for the past two years.
• No personal debt (revolving or installment) is being paid by the business (except business-use automobiles).
• Funds for down payment or closing costs are not from the business.
• Business structure (such as, partnership, corporation, sole proprietorship) has not changed in the past five years.
• Loan is a purchase or no cash-out refinance.
• Business income is not being used to qualify the borrower.</td></tr>
<tr><td>Tax returns for de minimus self-employed borrowers (Section 4.02)</td><td>No business tax returns are required.</td><td>Same as Refer.</td></tr>
</table>

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4.08 Documentation for Automated Underwriting Cases,
Continued

Documentation Guidelines for Assets

Refer to the following table for documentation guidelines for assets.

Subject and Reference	Documentation Classification	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept**
Verify closing costs (Section 4.04)	Verify veteran's source of funds for payment of any difference between sales price and loan amount plus closing costs, if sales price exceeds reasonable value established by a CRV or Notice of Value (NOV).	No verification of veteran's source of funds is required if closing costs plus difference between the sales price of the property and the base loan amount is <4% of the lesser of the following: • Sales price • Reasonable value established by a CRV or NOV.
Verify assets to close in applicant's name (Section 4.04)	Provide original bank statements or certified true copies covering the most recent two month period in lieu of a Verification of Deposit (VOD).	Provide original bank statements or certified true copies covering most recent one month period in lieu of a VOD.

4.09 How to Complete VA Form 26-6393, Loan Analysis

General

In order to properly enter information on VA Form 26-6393, the underwriter must understand and apply the guidelines provided in the preceding sections of this chapter. This form can be found at www.vba.va.gov/pubs/forms1.htm#5.

Self-explanatory items are **not** discussed in this section.

Section C, Estimated Monthly Shelter Expenses

It is important to estimate these expenses accurately based on

- property location, and
- type of house
  - old or new
  - large or small, and
  - type of construction, because the total (item 22) is carried down to item 43 as a deduction from monthly income to arrive at the balance available for family support.

Special instructions are listed in the following table.

Item	Special Instructions
16	If taxes are expected to increase, use the increased amount.
17	Include the flood insurance premium for properties located in special flood hazard areas.
18	If special assessments are anticipated, use the anticipated amount.
20	Consult local utility companies for current rates. Realistically estimate cost based on age, size, and type of construction of the house.
21	For condominiums or houses in a PUD (planned unit development), include the monthly amount of maintenance assessment payable to the homeowner's association. If the assessment is less than the maximum provided in the covenants or master deed and it appears likely that the assessment will be insufficient for operation of the condominium or PUD, include the maximum amount the veteran could be charged.

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4.09 How to Complete VA Form 26-6393, Loan Analysis,
Continued

Section D, Debts and Obligations

List all known debts and obligations of the applicant and spouse including any alimony and/or child support payments.

Place a check mark in the (✓) column next to any "significant" debt or obligation. See the topic "Analysis of Debts and Obligations" in Section 4.05, for an explanation of "significant."

Job Related Expense
Include any costs for dependent care, significant commuting costs, and any other direct or incidental costs associated with the applicant's (or spouse's) employment. Check mark this item if total job related expenses are significant.

Item 33, Federal Income Tax

Enter the applicant's estimated monthly Federal income tax. If the applicant has a Mortgage Credit Certificate, reduce the Federal income tax by the estimated tax credit.

Reference: See the topic "Income Tax Credits from Mortgage Credit Certificates" in Section 4.03.

Item 44, Balance Available for Family Support

Enter the appropriate residual income amount from the following tables in the "guideline" box. Residual income is the amount of net income remaining (after deduction of debts and obligations and monthly shelter expenses) to cover family living expenses such as food, health care, clothing, and gasoline.

The numbers are based on data supplied in the CES (Consumer Expenditures Survey) published by the Department of Labor's Bureau of Labor Statistics. They vary according to loan size, family size, and region of the country.

Special Instructions for Using Tables
Count **all** members of the household (without regard to the nature of the relationship) when determining "family size," including

- an applicant's spouse who is **not** joining in title or on the note, and
- any other individuals who depend on the applicant for support. For example, children from a spouse's prior marriage who are not the applicant's legal dependents.

Continued on next page

4.09 How to Complete VA Form 26-6393, Loan Analysis,
Continued

Item 44, Balance Available for Family Support (continued)

Special Instructions for Using Tables *(continued)*

Exception: The lender may omit any individuals from "family size" who are fully supported from a source of verified income which, for whatever reason, is **not** included in effective income in the loan analysis. For example

- a spouse not obligated on the note who has stable and reliable income sufficient to support his or her living expenses, or
- a child for whom sufficient foster care payments or child support is received regularly.

Reduce the residual income figure (from the following tables) by a minimum of 5 percent if

- the applicant or spouse is an active-duty or retired serviceperson, and
- there is a clear indication that he or she will continue to receive the benefits resulting from use of military-based facilities located near the property.

Use 5 percent unless the VA office of jurisdiction has established a higher percentage, in which case, apply the specified percentage for that jurisdiction.

A key to the geographic regions is listed in the following tables.

Table of Residual Incomes by Region For loan amounts of $79,999 and below				
Family Size	**Northeast**	**Midwest**	**South**	**West**
1	$390	$382	$382	$425
2	$654	$641	$641	$713
3	$788	$772	$772	$859
4	$888	$868	$868	$967
5	$921	$902	$902	$1,004
over 5	Add $75 for each additional member up to a family of 7.			

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4.09 How to Complete VA Form 26-6393, Loan Analysis, Continued

Item 44, Balance Available for Family Support (continued)

Table of Residual Incomes by Region
For loan amounts of $80,000 and above

Family Size	Northeast	Midwest	South	West
1	$450	$441	$441	$491
2	$755	$738	$738	$823
3	$909	$889	$889	$990
4	$1,025	$1,003	$1,003	$1,117
5	$1062	$1,039	$1,039	$1,158
over 5	Add $80 for each additional member up to a family of 7.			

Key to Geographic Regions Used in the Preceding Tables

Northeast	Connecticut Maine Massachusetts	New Hampshire New Jersey New York	Pennsylvania Rhode Island Vermont
Midwest	Illinois Indiana Iowa Kansas	Michigan Minnesota Missouri Nebraska	North Dakota Ohio South Dakota Wisconsin
South	Alabama Arkansas Delaware District of Columbia Florida Georgia	Kentucky Louisiana Maryland Mississippi North Carolina Oklahoma	Puerto Rico South Carolina Tennessee Texas Virginia West Virginia
West	Alaska Arizona California Colorado	Hawaii Idaho Montana Nevada	New Mexico Oregon Utah Washington Wyoming

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4.09 How to Complete VA Form 26-6393, Loan Analysis,
Continued

Item 45, Debt-to-Income Ratio

VA's debt-to-income ratio is a ratio of total monthly debt payments (housing expense, installment debts, and so on) to gross monthly income.

Add: Items 15 + 16 + 17 + 18 +21 +41 = Debt

Add: Items 32 + 39* = Income

Divide: Debt ÷ Income = Debt-to-Income Ratio

Round: To the nearest two digits

The "Debt-to-Income Ratio" heading in Section 4.10 contains special procedures to apply if the ratio exceeds 41 percent.

*Tax-free income may be "grossed up" for purposes of calculating the debt-to-income ratio only (**not** residual income). This is a tool that may be used to lower the debt ratio for veterans who clearly qualify for the loan. "Grossing up" involves adjusting the income upward to a pre-tax or gross income amount which, after deducting state and Federal income taxes, equals the tax-exempt income. Use current income tax withholding tables to determine an amount which can be prudently employed to adjust the borrower's actual income. Do not add non-taxable income to taxable income before "grossing up."

Tax-free income includes certain military allowances, child support payments, workers' compensation benefits, disability retirement payments and certain types of public assistance payments. Verify that the income is indeed tax-free before "grossing up."

If "grossing up" is used, indicate such and provide the "grossed up" ratio in item 48, "Remarks."

Item 46, Past Credit Record

Indicate whether the applicant (and spouse, if applicable) is a satisfactory or unsatisfactory credit risk based on a complete analysis of credit data.

4.10 How to Analyze the Information on VA Form 26-6393

Residual Income

VA’s minimum residual incomes (balance available for family support) are a guide. They should not automatically trigger approval or rejection of a loan. Instead, consider residual income in conjunction with all other credit factors.

An obviously inadequate residual income alone can be a basis for disapproving a loan.

If residual income is marginal, look to other indicators such as the applicant’s credit history, and in particular, whether and how the applicant has previously handled similar housing expense.

Consider whether the purchase price of the property may affect family expense levels. For example, a family purchasing in a higher priced neighborhood may feel a need to incur higher-than-average expenses to support a lifestyle comparable to that in their environment, whereas a substantially lower priced home purchase may not compel such expenditures.

Also consider the ages of the applicant’s dependents in determining the adequacy of residual income.

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4.10 How to Analyze the Information on VA Form 26-6393, Continued

Debt-to-Income Ratio

VA's debt-to-income ratio is a ratio of total monthly debt payments (housing expense, installment debts, and so on) to gross monthly income. It is a guide and, as an underwriting factor, it is secondary to the residual income. It should not automatically trigger approval or rejection of a loan. Instead, consider the ratio in conjunction with all other credit factors.

A ratio greater than 41% requires close scrutiny unless

- the ratio is greater than 41% solely due to the existence of tax-free income (Put notation regarding the tax-free income in the loan file or calculate an adjusted, smaller ratio based on "grossing up" of the tax-free income.), or
- residual income exceeds the guideline by at least 20 percent.

Loans Closed Automatically with Ratio Greater than 41%
Include a statement justifying the reasons for approval, signed by the underwriter's supervisor, unless residual income exceeds the guideline by at least 20 percent. The statement must

- not be perfunctory, or
- list the compensating factors justifying approval of the loan.

Credit History

A poor credit history alone is a basis for disapproving a loan.

If credit history is marginal, look to other indicators such as residual income.

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4.10 How to Analyze the Information on VA Form 26-6393, Continued

Compensating Factors

Compensating factors may affect the loan decision. These factors are especially important when reviewing loans which are marginal with respect to residual income or debt-to-income ratio. They cannot be used to compensate for unsatisfactory credit.

Valid compensating factors should represent unusual strengths rather than mere satisfaction of basic program requirements. For example, the fact that an applicant has sufficient assets for closing purposes, or meets the residual income guideline, is not a compensating factor.

Valid compensating factors should logically be able to compensate (to some extent) for the identified weakness in the loan. For example, significant liquid assets may compensate for a residual income shortfall whereas long-term employment would not.

Compensating factors include, but are not limited to the following:

- Excellent credit history
- Conservative use of consumer credit
- Minimal consumer debt
- Long-term employment
- Significant liquid assets
- Sizable down payment
- The existence of equity in refinancing loans
- Little or no increase in shelter expense
- Military benefits
- Satisfactory homeownership experience
- High residual income
- Low debt-to-income ratio
- Tax credits for child care, and
- Tax benefits of home ownership.

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4.10 How to Analyze the Information on VA Form 26-6393, Continued

Compare What Shelter Expenses will be to What Applicant Pays Now

Closely scrutinize a case in which the applicant will be paying significantly higher shelter expenses than he or she currently pays. Consider the

- ability of the applicant and spouse to accumulate liquid assets; such as cash and bonds, and
- amount of debts incurred while paying a lesser amount for shelter.

If an application shows little or no capital reserves and excessive obligations, it may not be reasonable to conclude that a substantial increase in shelter expenses can be absorbed.

4.11 Examples of Underwriting Deficiencies

Purpose

Because of the high loan-to-value ratios of VA-guaranteed loans, it is critical that underwriters use sound judgment. The underwriting deficiencies listed in this section represent a sample of actual deficiencies found on VA loans that went into default. The deficiencies were of such significance that many of the loans should **not** have been made.

Inadequate Development of Credit Information

Deficiencies included

- failure to compare documented information with the applicant's initial application
- failure to question and investigate obvious discrepancies
  - in the number of dependents or household size, and
  - between actual year-to-date average monthly earnings and the income claimed on the loan application
- failure to question multiple Social Security numbers for an applicant
- failure to determine future plans of an active-duty serviceperson whose separation from service is imminent, and
- accepting an explanation for a bad credit history without documenting the circumstances alleged to have caused the credit problem, judgment, or bankruptcy.

Missing Documentation

Deficiencies included failure

- to inquire about and document the payment history on previous home loans, including prior VA loans, and
- to obtain documentation of employment history during the previous two years.

Continued on next page

4.11 Examples of Underwriting Deficiencies, Continued

Verification and Procedural Errors

Deficiencies included

- requiring the veteran to sign partially completed or blank forms
- permitting income or asset deposit information to be handcarried by the applicant, real estate/sales agent, or a party other than the lender's specifically-designated employee
- addressing verification forms to an individual chosen by the applicant rather than to the employer's personnel or payroll department, and
- obtaining multiple/revised credit reports without validating the need for the subsequent reports.

Income Analysis Errors

Deficiencies included

- showing that an applicant is a salaried employee when, in fact, the applicant works solely on a commission basis, is a contract employee, or is actually self-employed
- failure to use net profit or net income from Schedule C of IRS Form 1040 rather than the gross income of an applicant who is self-employed
- using short-term, temporary, or sporadic income to qualify an applicant for a loan, and

  Examples of unreliable income sources include
  - overtime pay in an industry or area that is experiencing an economic slowdown or decline
  - income from a second job even though the applicant does not have a record of steadily working two jobs
  - rental income even though the applicant does not have verified experience as a landlord, and
  - poorly documented income from self-employment.

- qualifying a marginal applicant for a loan by using a buydown or graduated payment mortgage without establishing that the applicant's income will keep pace with the scheduled increase in mortgage payments. This is especially important in times of low inflation and stagnant or declining real estate markets.

Continued on next page

4.11 Examples of Underwriting Deficiencies, Continued

Other Analysis Errors

Deficiencies included

- failure to consider
  - changes in marital status or household size after application and prior to closing, and
  - pay statements showing deductions to creditors that are not shown on the application, credit reports, or deposit verifications
- approving a loan solely on the basis of an emotional appeal from the applicant or spouse, the sales agent, seller, or other interested party. A decision or an inclination to reject a loan application should **not** be changed unless there is new and compelling information available to justify approving the loan.
- approving high debt-to-income ratio loans with few or no valid compensating factors
- using gift letters to offset past due obligations, pay off debts, and so on, without consideration of the credit risk implications of the past due obligations
- ignoring debts, judgments, bankruptcies, alimony or child support obligations because they don't appear on the credit report, and
- failure to reconcile a large increase in shelter expense with an undemonstrated ability to accumulate cash assets.